

## Chapter 3: Financial Management

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### Introduction

With KCDBG, funding comes with certain administrative and financial management requirements. Financial management is the constant process of tracking progress towards financial objectives and safeguarding the financial assets of an organization. The key principles of financial management are common to all types of organizations and include sound accounting systems, allowability of costs, audits and use and tracking of program income. These requirements differ to some extent depending upon grant type.

This chapter details the financial management regulations and requirements that apply to the use of KCDBG funds.

### Section 3-A. Applicable Requirements

The CDBG regulations require grantees that are governmental entities or public agencies to adhere to certain administrative and financial management requirements.

These requirements include:

- ✓ **24 CFR Part 570**, Community Development Block Grant Program. Subpart I of 24 CFR Part 570 governs the state CDBG program. Section 570.489 details program administrative requirements.
- ✓ OMB Circular A-87 “Cost Principles for State, Local and Indian Tribal Governments.” This circular establishes principles and standards for determining allowable costs under Federal grants. OMB Circular A-110 establishes principles for determining allowable costs to nonprofit organizations.
- ✓ OMB Circular A-133 “Audits of Institutions of States, Local Governments and Nonprofit Institutions.” States, local governments, and nonprofit organizations are required to comply with OMB Circular A-133. This circular provides guidance to be directly followed regarding audits. These requirements include the type and level of audit required, reports issued by auditors, and audit review and resolution.
- ✓ Specific provisions of 24 Part 85, Administrative Requirements for Grants and Cooperative Agreements to State, Local and Federally Recognized Indian Tribal Governments (the Common Rule). These regulations set forth uniform requirements for financial management systems, reports, records, and grant close-outs for recipients of Federal grant funding. Subjects covered in Part 85 include financial management standards, internal controls, budget controls, accounting controls, cash management, procurement, and contracting. 24 CFR Part 84 covers the same subjects for nonprofit organizations.

24 CFR 570.489  
OMB Circular A-87  
OMB Circular A-133  
24 CFR Part 85

## Section 3-B. Establishing a Financial Management System

### Overview

Financial management is important to grantees administering KCDBG funding. A fundamental purpose of financial management is to ensure the appropriate, effective, timely and honest use of funds.

Specifically, grantees must ensure that:

- ✓ Internal controls are in place and adequate;
- ✓ Documentation is available to support accounting record entries;
- ✓ Financial reports and statements are complete, current, reviewed periodically; and
- ✓ Audits are conducted in a timely manner and in accordance with applicable standards.

### Requirements

In establishing a financial management system, grantees are to follow 24 CFR Part 85 “Administrative Requirements for Grants and Cooperative Agreements to state, Local, and Federally Recognized Indian Tribal Governments” (also known as the Common Rule).

24 CFR Part 85.20(b)(1-6)

Both the Common Rule and 24 CFR Part 570 govern CDBG grantee financial management systems. In addition, the use and accounting for KCDBG funds are governed by DLG requirements, OMB Circular A-87, HUD Notice CPD-04-11, and Treasury Circular 1075. KRS 91A.020 requires grantees to follow generally accepted accounting principles (GAAP). Failure to account for and manage KCDBG funds accordingly may result in sanctions imposed by DLG and/or HUD.

The Common Rule requires that the grantee’s financial management system provide the following:

- ✓ Accurate, current and complete disclosure of financial results;
- ✓ Records that identify adequately the source and application of grant funds;
- ✓ Comparison of actual outlays with amounts budgeted for the grant;
- ✓ Procedures to minimize the amount of time elapsed between the transfer of funds from the US Treasury and the disbursements by the grantee;
- ✓ Procedures for determining reasonableness and allowable costs;
- ✓ Accounting records that are supported by appropriate source documentation; and
- ✓ A systematic method to assure timely and appropriate resolution of audit findings and recommendations.

The three basic functions, which must be served by the financial management system, are:

1. The financial management system must have an identified procedure for recording all financial transactions.
2. All expenditures should be related to allowable activities in the grant agreement approved by DLG.
3. All expenditures of KCDBG funds must be in compliance with applicable laws, rules, and regulations.

**Tip:** Use the Sample Financial Management Checklist (see Attachment 3-1) as a tool to help your organization set up and maintain your financial management system.

Attachment 3-1:  
Sample Financial Management  
Checklist

Internal Controls

Internal controls refer to the combination of policies, procedures, defined job responsibilities, personnel and records that allow an organization (or an agency) to maintain adequate oversight and control of its cash, property and other assets.

The soundness of any grantee’s financial management structure is determined by its system of internal controls. Specifically, internal controls refer to:

- ✓ Effectiveness and efficiency of operations;
- ✓ Reliability of financial reporting; and
- ✓ Compliance with applicable laws and regulations.

With a sound internal control system, a grantee can ensure:

- ✓ Resources are used for authorized purposes and in a manner consistent with applicable laws, regulations, and policies;
- ✓ Resources are protected against waste, mismanagement or loss; and
- ✓ Information on the source, amount, and use of funds is reliable, secured, and up-to-date and that this information is disclosed in appropriate reports and records.

As part of an effective internal control system, one person should be designated as the primary person at the grantee organization responsible for the financial management of a KCDBG project. This person should be familiar with their organization’s present accounting system. The accounting of KCDBG funds can be integrated into the grantee’s existing system.

Basic Elements of an Internal Control System  
for Financial Management

1. Organizational chart showing lines of authority for all individuals involved in approving or recording financial transactions.
2. Written position descriptions describing responsibilities of all employees with a relationship to financial and accounting issues.
3. Written policy manual specifying approval authority for financial transactions and guidelines for controlling expenditures.
4. Written procedures for recording of financial transactions, as well as an accounting manual and a chart of accounts.
5. Adequate separation of duties to assure that no one individual has authority over an entire fiscal transaction.
6. Hiring policies that ensure financial staff qualifications are equal to job responsibilities and that individuals hired are competent to do the job.
7. Access to accounting records, assets, blank forms, and confidential records are adequately controlled, such that only authorized persons can get access to them.
8. Procedures for regular reconciliation of financial records, comparing a grantee’s records with actual assets and liabilities of the organization.

Accounting Records

Each grantee should determine the accounting procedures that will assist in providing accurate and complete financial information. Grantees are required to maintain accounting records that sufficiently

identify the source and use of the KCDBG funds provided to them. All records must be supported by source documentation (see the next section).

The grantee may have KCDBG accounting records fully integrated into an existing accounting system. Grantees may also have partially integrated records into an existing system; however, ledgers should be developed to provide the required accounting information for the KCDBG grant. Separate records eliminate potential conflicts with the grantee's usual record keeping systems.

At a minimum, a grantee's accounting system, must:

- ✓ Clearly identify all receipt and expenditure transactions of the grant; and
- ✓ Provide for budgetary control by tracking expenditures and accrued obligations by approved activity.

DLG staff or the grantee's auditors should be able to readily trace all transactions through the accounting system at any time during the grant period of performance or after grant close-out.

## Budget Controls

The grantee must be able to report expenditures for each approved activity. A record of the account balances must be maintained for each approved activity that accounts for expenses accrued as well as obligations that have been incurred but not yet been paid out.

## Source Documentation

Accounting records must be supported by source documentation per 24 CFR Part 85. Source documentation includes many items such as cancelled checks, paid bills, payrolls, time and attendance records, contract documents and other paperwork.

**Tip:** It is important that a grantee establish a system in which all source documents pertaining to the project are clearly marked by an identifier on each source document. This will help assure that transactions are properly classified and segregated in the accounting records.

24 CFR 85.20(b)(6)

Source documentation should tell the story of the basis of the costs incurred and the actual dates of the expenditure. For example, source documentation on payments to contractors would include a request for payment, proof of inspection to verify work and materials, and cancelled checks. DLG encourages the use of purchase orders or payment vouchers when preparing expenditures for payment of any cost associated with the project. These documents are prepared in accordance with local policies and procedures as well as those required by Federal regulations.

Additionally, contracts should be kept in a file separate from accounting files. The signed contract represents an obligation of funds. When payments are made on the contract, they should be recorded in the contract file.

## Receipt of Funds Procedures

In addition to CDBG funds received from DLG, receipt of other project funds may also include program income and project funds received from other sources.

The grantee must be certain that project funds are adequately safeguarded. This includes providing proper bonding of those individuals that handle program funds, in accordance with state and local law.

All project funds should be promptly deposited to the proper bank account and recorded as a receipt in the accounting system. KCDBG funds are to be drawn from DLG only as required to pay immediate obligations.

### Payment Procedures

Before the grantee can expend any funds, the grantee's budget must include appropriations for the grant. Additionally, the budget must be approved and enacted by the appropriate legislative body.

A Request for Payment (Attachment 3-2) may not be submitted until the grantee has received a Notice of Release of Funds. Grantees may request only the amount of funds needed to pay immediate obligations. Grantees must submit Requests for Payment to DLG by the 3<sup>rd</sup> and the 18<sup>th</sup> of the month. More information on Requests for Payment is provided in Section 3 of this chapter.

Attachment 3-2:  
Request for Payment Form

In order to safeguard the grant funds and ensure an effective system of internal controls, an individual apart from the person authorized to request funds should approve expenditures. Additionally, all invoices should be reviewed to determine that the costs are accurate, reasonable, and allowable. DLG is required to ensure that program income is expended before additional funds are drawn down. To allow DLG to track available program income, grantees are required to report all program income that has been received since the last draw of CDBG funds on the Request for Payment Form. Refer to Section 3-C for additional information on tracking and reporting program income.

### *Invoices and Vouchers*

To assist in the planning for the Request for Payment, grantees should establish an internal deadline for submission of all invoices and vouchers.

Before providing full payment for a contractor's invoice, grantees should verify that the work has been completed. This is a good time to ensure that all payments for expenditures are supported by source documentation (i.e., invoices or vouchers and kept on file). A list of disbursements to be made should be prepared and the cash requirements submitted to DLG on the Request for Payment form. Refer to Section 4 of this chapter for more information on requests for payment.

### Bank Accounts

In dealing with CDBG funds, the grantee is required to maintain a **non-interest bearing** bank account for the deposit of CDBG funds. The account must be FDIC insured or secured by bank-pledged collateral for the full amount of KCDBG funds held in the account. The bank must provide collateral to secure those funds that are in excess of \$100,000.

It is important that the grantee be able to reconcile all balances in the account. Grantees should reconcile bank statements as soon as bank statements are received.

Grantees may not earn interest on the deposit of Federal funds pending disbursement. All Federal funds on hand must be disbursed before requesting additional funds. If excessive amounts of cash (over \$5,000) are or will be on hand for an extended period of time (over five days), the grantee must return the excess to DLG.

## Forms

After establishing the accounting system and bank account to be used, the grantee needs to complete two forms:

Attachment 3-3: Authorized  
Signature Form

Attachment 3-4: Direct Electronic  
Transfer of Funds Form

- ✓ **The Authorized Signature Form.** This form designates to DLG who has the authority to sign grant documents and reports. Only a person listed on this form may sign Request for Payment forms. The grantee's CEO must sign the form and submit it to DLG. A copy of the form is provided as an attachment to this chapter.
- ✓ **Direct Electronic Transfer of Funds Form.** This form is used to designate the bank and the account number into which DLG will deposit the grantee's KCDBG funds. The grantee should complete the community and project information section. With the assistance of the designated bank, the grantee must complete the depository information. The grantee's CEO should then sign the form, **attach a deposit slip or voided check to the form**, and submit it to DLG. A copy of the form is provided as Attachment 3-4 to this chapter.

### Common Mistakes to Avoid

- ✓ Failure to maintain records that track KCDBG expenditures by activity.
- ✓ Lack of source documentation for KCDBG expenditures.
- ✓ KCDBG funds drawn down being held in an interest bearing account.
- ✓ Bank statements not reconciled.
- ✓ Program income not reported.
- ✓ Inadequate documentation of local administrative costs.
- ✓ Lack of tracking of real or personal property purchased with CDBG funds.

## Allowable Costs

Any cost incurred must be in line with 24 CFR Part 85 and OMB Circular A-87. It is a grantee's responsibility to ensure that CDBG funds are spent only on reasonable and necessary costs associated with grant activities.

The grantee must establish policies and procedures for determining cost reasonableness, allowability, and allocability of costs.

## Administrative Costs

Administrative costs are the costs associated with implementation of the grant. These costs may include salaries for personnel who devote full or part time to the grant, supplies used for grant activities, and the cost of administrative services provided by other agencies. General administration costs are those costs **directly** related to the administration of grant requirements.

In charging administrative costs, grantees should note:

- ✓ All administrative costs charged to the project must be documented through timesheets, purchase orders, and invoices.

- ✓ For those projects directly administered by the grantee, employees paid in whole or in part from KCDBG funds should prepare timesheets indicating the hours worked for each pay period.
  - Timesheets must show the exact hours each individual worked on the project, the hours worked on non-KCDBG projects, the date on which the work was performed and a description of the work performed.
  - The employee and the employee's supervisor must sign the timesheet.

## Matching Funds

Grant records should account for all matching funds committed to the project. The receipt and expenditure of the matching funds should be carefully documented. If matching funds are derived from a source outside the local government, project records should identify the source and amount. Guidelines for appropriate matching contributions are contained in the Common Rule and the amount of match required is shown in the grant agreement.

## Asset Management

Grantees who maintain real or personal property paid in whole or in part with KCDBG funds are required to properly manage these assets and ensure that the assets continue to be used for their intended purposes.

Grantees must maintain appropriate records of their assets, whether in their possession or in the possession of a subrecipient organization. Specifically:

- ✓ In the case of real property, meaning land and any improvements to structures on the land, grantees must maintain a current real property inventory, updated at least biannually. In cases where the grantee is maintaining land, grantees should also describe the intended reuse of the land and the timeframe for improving the land so that it meets a CDBG national objective.
- ✓ For personal property, grantees should maintain a fixed assets ledger that includes: a description of the property; any identifying information such as a serial number; the funding source (grant number); the acquisition date and cost; the Federal share of the cost; and the location, use, and condition of the property; and disposition data. Grantees are required to conduct a physical inventory of personal property biannually to ensure that the property is being maintained in good condition and that there are procedures in place to prevent loss, damage, or theft of the property.

24 CFR 570.489(j) and (k)  
24 CFR Part 85

Grantees must maintain records that properly document the disposition of any CDBG-funded property. It should be noted that real property purchased with KCDBG funds in excess of \$100,000 must continue to meet the CDBG national objective approved for the project for at least five years after close-out of the grant that funded the property purchase or improvement. Should the recipient choose to change the use of property they must contact DLG to ensure that proper procedures are followed. Failure to do so can result in payback of the grant award.



## Section 3-C. Program Income, Miscellaneous Revenue and LDA Proceeds

### Overview

Any repayment of funds or proceeds generated from a KCDBG activity will fall into one of three categories; 1) program income, 2) miscellaneous revenue, or 3) LDA proceeds. Different rules apply for each of these three categories. The following section defines each of these types of funds and the rules that will apply.

Under the KCDBG Program, funds received back to the community as a result of a KCDBG-funded activity are generally referred to as program income. Program income funds retain their federal identity and are subject to all CDBG and other Federal requirements. Program income is defined in detail below. Funds not considered program income, including miscellaneous revenue and local development authority (LDA) proceeds, will be covered in the next section.

It is important to note that accounting for program income is conducted on a jurisdictional basis rather than a project basis because a grantee has the ability to generate income from more than a single project or over more than one grant year.

**TIP:** The regulations and requirements discussed in this chapter apply to all types of income-generating activities, not just economic development.

### What Is Program Income

Program income is defined as gross income received by a unit of general local government or a subrecipient of a unit of general local government that was generated from the repayment of KCDBG funds regardless of when the funds were appropriated and whether the activity has been closed out. Program income includes, but is not limited to, the following:

- ✓ Proceeds from the disposition by sale or long-term lease of real property purchased or improved with KCDBG funds;
- ✓ Proceeds from the disposition of equipment purchased with KCDBG funds; 24 CFR Part 570.489(e)(1)
- ✓ Gross income from the use or rental of real or personal property acquired by the unit of general local government or a subrecipient of a unit of general local government with KCDBG funds, less the costs incidental to the generation of the income;
- ✓ Gross income from the use or rental of real property owned by the unit of general local government or a subrecipient of a unit of general local government, that was constructed or improved with KCDBG funds, less the costs incidental to the generation of the income;
- ✓ Payments of principal and interest on loans made using KCDBG funds;
- ✓ Proceeds from the sale of loans made with KCDBG funds;
- ✓ Proceeds from the sale of obligations secured by loans made with KCDBG funds;
- ✓ Interest earned on funds held in a revolving fund (RF) account;



- ✓ Interest earned on program income pending disposition of the income;
- ✓ Funds collected through special assessments made against nonresidential properties and properties owned and occupied by households that are not low and moderate income if the special assessments are used to recover all or part of the KCDBG portion of public improvements; and
- ✓ Gross income paid to a unit of general local government or subrecipient from the ownership interest in a for-profit entity acquired in return for the provision of KCDBG assistance.

Program income does not include the following:

- ✓ The total amount of funds which does not exceed \$35,000 received in a single year from activities other than revolving funds that is retained by the unit of local government and its subrecipients; these funds are considered miscellaneous revenue;
- ✓ Amounts generated by activities eligible under Section 105(a)(15) of the Act and carried out by an entity under the authority of Section 105(a)(15) of the Act (non-profit organizations and local development organizations, such as LDAs, when undertaking community economic development, neighborhood revitalization, or energy conservation projects) (these funds are referred to as LDA proceeds); Payments of principal and interest made by a subrecipient carrying out an activity on behalf of the unit of local government towards a loan from the local government to the subrecipient to the extent that program income is used for the repayment;
- ✓ Certain types of interest income as outlined in 24 CFR 570.489(e)(2)(iv);
- ✓ Proceeds from the sale of real property purchased or improved with CDBG funds if the proceeds are received more than five years after expiration of the grant agreement between the state and the unit of local government.

Funds not considered program income will be identified as either miscellaneous revenue or LDA proceeds. These funds do not retain their Federal identity and the CDBG and other Federal requirements such as environmental review, procurement, and labor standards do not apply to the reuse of these funds. However, DLG does require that grantees or subrecipients generating miscellaneous revenue adopt guidelines related to the reuse of and reporting on those funds.

### ***Pro-Rating Program Income***

When income is generated by an activity that is only partially assisted by KCDBG funds, the income shall be pro-rated to reflect the percentage of KCDBG funds used. For example, if a parcel of land were purchased with 50 percent KCDBG funds and 50 percent other funds, 50 percent of any program income from the sale or long-term lease of that property would be considered KCDBG program income subject to CDBG rules and requirements.

24 CFR Part 570.489(e)(1)(ix)

### **Program Income Funds and Close-Out**

The State CDBG regulations as revised in April 2012 stipulate that program income received by the grantee or a subrecipient both before **and** after close-out of the grant that generated such income is treated as additional CDBG funds and is subject to all applicable Title I and other Federal regulations and state policies governing the state CDBG program. Any program income received before full programmatic close-out must be substantially expended, to the extent practical, before drawing

additional CDBG funds from the state for any activity in any CDBG project that the grantee has open. The only exception is when program income is placed in a Revolving Fund (RF) in accordance with the requirements outlined later in this chapter, in which case it is not required to be expended for non-revolving fund activities.

If the grant that generated the program income is closed, any program income permitted to be retained, will be considered part of the unit of local government's most recently awarded open grant

## Use of Program Income

The accounting provisions and use of funds as described later in this chapter are applicable as long as funds are received or distributed. Appropriate documentation regarding the use of funds must be maintained along with the appropriate accounting documents (see "Accounting and Documenting Program Income and Miscellaneous Revenue" later in this chapter for more information).

Program income must be used for eligible CDBG activities as listed in Title I, Section 5305(a). Program income is subject to all of the rules and regulations governing KCDBG funds including, but not limited to, compliance with: national objective, procurement, equal opportunity, environmental, labor standards, lead-based paint hazard treatment, etc. As stated previously, miscellaneous revenue and LDA proceeds are not subject to these rules.

The grantee can expend up to 20 percent of the total program income received for administration with approval from DLG. The 20 percent limitation is established by Federal regulation and cannot be exceeded under any circumstances.

## Approval for Use Request for Program Income and Miscellaneous Revenue

In order to expend program income, a grantee must request approval from the state. An Approval for Use Request (Attachment 3-5) and related certifications must be submitted prior to local approval of the project. DLG staff will review the request to determine conformance with eligibility and national objective requirements, if applicable. In most cases, a grantee must use program income on a new proposed project.

Grantees looking to expend their miscellaneous revenue funds will need to establish that the funds qualify as miscellaneous revenue and are thus exempt from the program income use requirements. Further details are provided later in the section. .

Attachment 3-5:  
Approval for Use Request

As a condition to grants currently being funded, DLG requires program income be used before requesting additional KCDBG dollars. If approved, the transaction is reported on the subsequent Semi-Annual Repayment—Program Income/Miscellaneous Revenue/LDA Proceeds Report (Semi-Annual Repayment Report).

## Transfer of Program Income and Miscellaneous Revenue

Due to a statutory provision mandating that KCDBG funds benefit the eligible grantee that received the original funds, a grantee cannot transfer program income to another agency for use in other cities or counties.

## Accounting Systems for Program Income and Miscellaneous Revenue

A program income/miscellaneous revenue accounting system should:

- ✓ Record program income/miscellaneous revenue appropriately in the grantee's accounting records;
- ✓ Ensure that all program income/miscellaneous revenue is collected and properly classified; and
- ✓ Ensure that the handling of program income/miscellaneous revenue complies with applicable Federal and state requirements.

The method of accounting to be used for tracking program income/miscellaneous revenue shall meet Generally Accepted Accounting Principles (GAAP). Any accounting system used must be detailed enough to provide the necessary information for completing DLG's Semi-Annual Repayment Report (Attachment 3-6) and comply with the requirements of 24 CFR Part 85. A separate interest-bearing account must be maintained for a revolving fund.

[Attachment 3-6: Semi-Annual Repayment Report](#)

The grantee must maintain files that accurately account for all funds received and disbursed. This documentation must include bank statements and canceled checks (copies are acceptable if both sides of canceled checks are copied).

The grantee must also maintain documentation that shows program income funds were spent in compliance with Title I requirements. This includes documentation that the funds were spent on eligible activities, that a national objective was met, and that all other requirements such as environmental review, fair housing, relocation and citizen participation were complied with. See also *Chapter 1: Administration* for more information on the records that must be kept to demonstrate compliance.

## Revolving Funds

Revolving funds are a special category of program income that allows the funds to be set aside for a designated use. A revolving fund (RF) is a separate fund (with a separate set of accounts that are independent of other program accounts) established to carry out specific activities that, in turn, generate payments that fund future activities.

DLG may approve the use of KCDBG program income for the purpose of capitalizing a RF for specifically identified activities.

[24 CFR Part 570.489\(f\)](#)

- ✓ RFs are typically established to continue housing or economic development activities.
- ✓ The establishment of a RF must be in the evidentiary materials and approved by DLG.

Payments to the RF are considered program income and as such, must be substantially disbursed from the RF before additional grant funds are drawn from DLG. For example, if the grantee receives a loan payment on an RF economic development activity, the loan payment back to the RF is considered program income. The next draw request by the grantee for an economic development activity must substantially disburse the available economic development RF before grant funds can be drawn from DLG. If the grantee's next draw request is for a public service activity this would not require the use of the RF funds

[Attachment 3.2: Request for Payment](#)

since the drawn request does not match the specified purpose of the RF. The grantee does not have to expend program income for non-revolving fund activities.

If the RF is established to continue the activities of the grant that generated the program income, the RF is subject to all the requirements of program income (i.e., Title I, state policies, etc.), if the grant is open at the time the funds are received.

## **Development of Revolving Fund Guidelines**

DLG requires that written guidelines be developed for the administration of the revolving fund. These guidelines must be prepared and submitted to DLG for approval prior to any program income being expended and prior to release of funds of the grant. Revolving funds may not be expended until the project national objective has been met.

The local governing body must approve the written RF guidelines. In addition, any substantive changes to local RF guidelines must be submitted to DLG prior to implementation. Failure to submit local RF guidelines in a timely manner could result in the recapture of program income by DLG.

Administration of a RF involves three primary areas of responsibility:

- ✓ Loan/project review, selection and approval;
- ✓ Maintaining a financial management system; and
- ✓ Loan servicing and monitoring.

At a minimum, the written RF guidelines should include the following elements that address these primary areas of responsibility:

- ✓ RF Goals and Objectives
- ✓ Eligibility Requirements
  - Eligible and Ineligible Activities
  - Eligible Applicants
  - Eligible Types of Loans
- ✓ Loan Review, Selection and Approval
  - Loan Review Committee
    - Members and Terms
    - Procedures and By-Laws
  - Application Requirements
    - Justification of Need
    - Beneficiaries
    - Necessary and Appropriate Documentation
    - Certifications
  - Loan Approval Procedures

- ✓ RF Operations and Management
- ✓ Accounting System
- ✓ Reporting and Record keeping
- ✓ Loan Documentation, Disbursement and Servicing
- ✓ Title I Compliance and Monitoring
- ✓ Administrative Staffing, Costs and Fees
- ✓ Audits
- ✓ Conflict of Interest

Sample RF Guidelines are provided at the end of this Chapter as Attachment 3-7.

Attachment 3-7:  
Sample Revolving Fund Guidelines

### Subrecipients and Revolving Funds

If program income/miscellaneous revenue will be retained by a subrecipient, the RF guidelines must identify and describe the role of the subrecipient, as appropriate. The subrecipient's governing board must approve the RF and the subrecipient's participation prior to release of funds. Such approval must legally bind the subrecipient to perform in accordance with the provisions of the revolving fund guidelines and be submitted in writing to DLG. It is a Federal requirement that a subrecipient be governed by the KCDBG regulations in the same manner and to the same extent as the grantee. In any case, the grantee remains responsible for ensuring compliance with the RF and is liable for any misuse of program income/miscellaneous revenue funds.

### Waiver of Requirements

DLG may waive or modify the requirements of this chapter when it determines that, in so doing, it will promote the more efficient administration of the program and/or further the accomplishment of objectives. However, DLG cannot waive HUD or other Federal regulatory requirements concerning the use of program income.

### Monitoring of Revolving Funds

Revolving funds will be monitored periodically by DLG to insure compliance with all Federal and state requirements. A grantee must agree to return all unexpended funds and collectable accounts to DLG in the event of fraud, waste, or mismanagement and/or substantial non-compliance with the local RF guidelines.

### Reporting of Revolving Funds

HUD requires vigorous oversight of program income retained at the local level. Therefore, DLG must ensure the proper use of these funds is in a manner consistent with CDBG requirements. For this reason, the Semi-Annual Repayment Report is required (see Attachment 3-6).

Attachment 3-6:  
Semi-Annual Repayment Report

A grantee generating program income must submit a report for the six-month period ending June 30<sup>th</sup> and December 31<sup>st</sup> of each year.

## **Subrecipients and Reporting**

Since the grantee has ultimate responsibility for grant compliance, that entity is responsible for completion and submission of the report. Should the grantee utilize a subrecipient organization to manage a RF, the subrecipient organization entity is responsible for providing the necessary program and financial information required for the report to the grantee, and the grantee should then send the report to DLG.

## **Monitoring**

Review of the Semi-Annual Repayment Report may be included as part of a normal project monitoring. Any deficiency that is noted and appears as a finding in the monitoring letter must be resolved as would any other finding. Refer to Chapter 12 for more information on monitoring.

## **LDA Proceeds**

As defined earlier in the Chapter, Section 105(a)(15) of the Act allows DLG to designate non-profit organizations and local development organizations as Local Development Agencies (LDA). These organizations when undertaking community economic development, neighborhood revitalization, or energy conservation projects can generate income that will not be considered program income and not hold the federal requirements of its original source of funds. These funds will be referred to as LDA proceeds. LDA proceeds are generated when a grantee provides CDBG funds to a DLG designated LDA to implement a CDBG eligible activity, such as economic development. In this example, DLG would designate in the funding agreement with the grantee that the funds would be administered by the LDA and income generated from the activity would be considered LDA proceeds and exempt from program income requirements. This exception to the program income designation only applies to a designated LDA project and only covers generated income that is received back by the LDA. If payments such as principal and interest generated from an LDA funded project were paid to the Grantee or subrecipient, these funds would be program income, continue to hold their federal identify, and fall under all of the program income requirements listed in the earlier section of this chapter.

## **Use of LDA Proceeds**

DLG will work with the LDA to establish a re-use plan for LDA proceeds. The LDA may choose to set up an RF to target and market the use of LDA proceeds to further the mission of the LDA. Because the LDA proceeds are not considered to retain their federal identity, their reuse does not trigger the CDBG requirements or other federal requirements such as environmental review and federal labor standards.

## **Transfer of LDA Proceeds**

The exemption from the program income requirements only applies to funds generated from an LDA activity that are retained by the LDA. If LDA proceeds are transferred to or repaid to the CDBG grantee these funds would trigger all of the program income reporting and reuse requirements detailed in the earlier program income section of this chapter.

## Monitoring of LDA Proceeds

LDA proceeds will be monitored periodically by DLG to insure compliance with KCDBG requirements. Monitoring may include verification of the information provided in the Semi-Annual Repayment Report.

Attachment 3-6:  
Semi-Annual Repayment Report

## Reporting of LDA Proceeds

DLG will track compliance with LDA proceeds requirements through the review of the Semi-Annual Repayment Report.

## Section 3-D. Requests for Payment

Funds for approved KCDBG activities should be requested as close to the time of disbursement as is possible. To ensure continued public awareness and fiscal oversight of the project, the project administrator should report project information to the city council/fiscal court monthly. This report should include project progress, anticipated completion date, and the use and availability of funding.

### Procedures

Submit all requests for payment of KCDBG funds to DLG on the form provided. If possible, please hold the draw request until there is a fair amount of money to request (i.e., \$2,000). The request should outline the:

- ✓ Amount of Federal funds previously requested;
- ✓ Amount of Federal funds disbursed;
- ✓ Amount of program income; and
- ✓ Balance of Federal funds on hand.

If a grantee has received more than one grant, a separate request should be completed for each grant. The number of requests for CDBG funds should be consolidated to the extent possible and timed to be in accord with the actual, immediate cash requirements of the grantee in carrying out the approved activities.

Program income will be disbursed by the grantee before additional funds are requested. Cash on hand will be subtracted from the amount of funds requested.

### Request for Payment Form Completion

The following outlines the method for submitting the Request for Payment Form (see Attachment 3-2). Grantees may submit this form to DLG twice monthly, by the 3<sup>rd</sup> and the 18<sup>th</sup> of the month. A copy of the form is provided as an attachment to this chapter.

Attachment 3-2:  
Request for Payment Form

#### **General**

The top portion of the Request for Payment form should be completed with the appropriate identifying information:

- ✓ **KCDBG Grant Number**—The number assigned to each grant as noted on the Grant Agreement.



- ✓ **Request Number**—Each Request for Payment will be consecutively numbered by the grantee. If a grantee has received more than one grant, a Request for Payment will be made separately and numbered consecutively for each grant.

On all forms, the grantee should round all dollar amounts to the nearest dollar.

### ***Part I—Status of Funds***

Part I of the Request for Payment provides the status of funds. Fill in the fields with the following information:

- ✓ **Line 1**—List all KCDBG funds received to date.
- ✓ **Line 2**—List the program income received from KCDBG activities since the last draw.
- ✓ **Line 3**—Add lines 1 and 2.
- ✓ **Line 4**—List the total of all disbursements of KCDBG funds to date.
- ✓ **Line 5**—Subtract line 4 from line 3. This gives the Federal funds on hand that have not been disbursed, a.k.a. the organization’s “cash on hand.”

### ***Part II—Cash Requirements***

Part II of the Request for Payment provides information on the funds the grantee is requesting. Part II is to be completed for all approved activities even if funds are not currently being requested for a particular activity.

- ✓ The first three lines give an overview of a grantee’s activities. Identify the activities by entering the activity code and a brief description above each column. The current approved budget amount for each activity should be included as well. Totals should be calculated at the far right as well as at the bottom.
- ✓ **Line 1**—Enter the total of all KCDBG cash requirements to date for each approved activity. This amount should be equal to all KCDBG expenditures paid to date plus cash needed to meet immediate needs.
- ✓ **Line 2**—Show the total amount of KCDBG funds requested on previous draw requests.
- ✓ **Line 3**—Subtract line 2 from line 1. This will result in the amount of KCDBG funds needed on this request for each activity.

If there are more than nine activities, use a second request form to include all activities. The second page should contain the total for both pages and the authorized signature.

### ***Part III—Project Status***

Part III describes in brief the status of the project. This section should include accomplishments achieved since the last request and if necessary discussion of any project delays.

After the narrative, indicate the amount of other funds drawn and expended on this project. Break these funds down using the classifications shown in the grant agreement.

### ***Certification***

After reviewing the form and verifying that all of the conditions listed in the certification have been complied with, the CEO or person authorized on the Authorized Signature Form should sign and date the form in the space provided.

Once the form is completed, the grantee should mail the **original** form to DLG.

#### **Common Mistakes to Avoid**

- ✓ Unsigned or improperly signed Requests for Payment are submitted.
- ✓ All approved activities not shown on each Request for Payment.
- ✓ Disbursements to date are not correct.
- ✓ Amounts not rounded to nearest dollar.
- ✓ Mathematical errors.
- ✓ Budget Amendments have not been approved.
- ✓ Status of project not included.

## **Section 3-E. Audits**

One of the primary financial management requirements implicit with the use of Federal funds is the annual audit. OMB Circular A-133 provides requirements for audits of governmental entities and nonprofit organizations.

Audits are a critical component of any financial management system and the Kentucky Revised Statutes (KRS) emphasize the significance of audits. Regardless of the type or size of the entity, an effective audit can improve management operations and yield significant dollar savings.

### **Audit Requirements**

An audit is an official examination and verification of accounts and records. Audits are an important part of effective financial systems, as they produce useful financial reports and verify the reliability of a grantee's financial management systems. Only an independent CPA, with a current license to practice in Kentucky, or the Kentucky Auditor of Public Accounts can perform an audit.

There are both Federal and state requirements for audits. OMB Circular A-133 provides Federal requirements for audits of governmental entities and nonprofit organizations. The KRS detail the state audit requirements for both cities and counties. As noted below, there are differences between both the KRS and Federal requirements; however, cities and counties are required to follow both laws.

Failure to comply with the audit requirements can jeopardize the grantee's ability to draw grant funds and receive future grants.

#### ***Federal Requirements***

The type and level of audit required by OMB Circular A-133 is based on the amount of Federal funds expended by an organization in a given fiscal year. Federal awards include financial assistance provided by the Federal government to the entire organization in the form of grants, loans, property, contracts, loans guarantees, etc.

- ✓ Organizations that have expended more than \$500,000 in Federal funds within a fiscal year are required to have an A-133 audit conducted.
  - A **single audit** is an audit that includes both an entity's financial statements and its Federal awards (from all applicable Federal programs).
- ✓ If an organization expends less than \$500,000 a year in Federal funds, it is exempt from the Federal audit requirements for that year, however, financial records must be made available if requested.

### **State Requirements**

KRS 91A.040 and KRS 64.80 require an independent Certified Public Accountant (CPA) or the Auditor of Public Accounts conduct all audits in accordance with generally accepted governmental auditing standards. The specific requirements for cities and counties are outlined below.

KRS 91A.040

KRS 91A.040 outlines Kentucky Audit Requirements for funding received by cities through the Commonwealth of Kentucky. City officials are responsible for obtaining audit services, negotiating the contracts for the annual audit, and submitting audit reports to DLG.

- ✓ All **first through fifth class cities** must audit their funds at the end of each fiscal year. All audits must be completed by February 1<sup>st</sup> immediately following the fiscal year being audited.
- ✓ **Sixth class cities** that receive and expend more than \$75,000 or have long-term debt are required to have audits in odd years and comply with the provisions for other cities. In even years, these cities prepare the KRS 424.220 financial statement and send one copy to the DLG Cities Branch. Sixth class cities that receive and expend less than \$75,000 in a particular year and have no long-term debt, are not required to have an audit for that year. These cities must prepare a financial statement only.

All counties must audit their funds at the end of each fiscal year. The Office of the State Auditor of Public Accounts or a CPA must conduct an annual audit of the funds in each county's budget.

### **The Audit Process**

In procuring audit services, grantees should follow the applicable procurement standards. The grantee should ensure that the auditor is knowledgeable about specific accounting requirements that apply to local government.

All audits conducted in accordance with OMB A-133 must be performed in accordance with Generally Accepted Government Accounting Principles (GAAP) issued by Government Accounting Office (GAO). According to the GAO standards, a financial audit should determine whether:

- ✓ Financial information is presented in accordance with established or stated criteria;
- ✓ The entity has adhered to specific financial compliance requirements; or
- ✓ The entity's internal control structure over financial reporting and/or safeguarding assets is suitably designed and implemented to achieve control objectives.

In conducting an audit, the grantee **must** supply the following information to the auditor at the beginning of each audit:

- ✓ A copy of the Grant Information Sheet received with the Grant Agreement;
- ✓ A copy of the Grant Agreement;
- ✓ A copy of all draw sheets processed during the fiscal year;
- ✓ A copy of the monitoring letter, if one was issued during or affecting the fiscal year being audited;
- ✓ A copy of the community's most recent budget that includes the CDBG funds for the fiscal year; and
- ✓ The location of the records for the CDBG project and the person to contact along with their telephone number.

**Tip:** It is the responsibility of both the grantee and the grant administrator to ensure compliance with all audit requirements.

### The Audit Report

OMB Circular A-133 requires that audit reports issued upon completion of an audit include:

- ✓ An opinion as to whether financial statements are presented fairly in all material respects in accordance with GAAP.
- ✓ An opinion as to whether the schedule of expenditures is presented fairly in all material respects in relation to the financial statements taken as a whole.
- ✓ A report on internal controls related to financial statements and major programs.
- ✓ A report on compliance with laws, regulations, and the provisions of contracts or grant agreements.
- ✓ An opinion as to whether the auditee organization has complied with laws, regulations, and the provisions of contracts or grant agreements.
- ✓ A schedule of findings and questioned costs, which include a summary of the auditor's results and all "audit findings."
- ✓ The summary of audit results must include:
  - Type of report the auditor issued on financial statements;
  - A statement that reportable conditions in internal controls were disclosed by the audit (where applicable);
  - Statement on whether the audit disclosed any noncompliance which is material to the auditee financial statements;
  - Type of report the auditor issued on compliance for major programs;
  - Statement as to whether the audit disclosed any "audit findings";
  - Identification of major programs;
  - Dollar threshold used to distinguish between type A and type B programs; and
  - Statement as to whether the auditee qualifies as a low-risk organization.

## Submission

The submission of all audit information is the responsibility of the grantee. It is the administrator's responsibility to inform the grantee of all audit requirements and to ensure that completed audit reports are submitted to DLG and the appropriate offices on a timely basis.

### ***Federal Submission Requirements***

Under OMB Circular A-133, audits must be completed within nine months from the end of the fiscal year.

Grantees have no later than 30 days after receipt of the auditor's report or March 31<sup>st</sup> (whichever is earlier) to submit the final copies to the Federal Audit Clearinghouse (FAC). The grantee should also forward one copy to DLG, Office of Federal Grants.

### ***State Submission Requirements***

All city audits and county audits done by a CPA must be completed by the February 1 immediately following the end of the fiscal year. County audits completed by the State Auditor's office are due by August 1.

State statute requires cities to submit three copies of the audit to the Financial Services Branch of DLG. KCDBG grantees must also send an additional copy to the Office of Federal Grants in order to meet the CDBG-related requirements.

For counties, the fiscal court or county official should submit the accountant's written report to the Governor, the General Assembly, the Attorney General, the State Librarian, and the county attorney. A copy must also be provided to DLG to comply with CDBG requirements.

Additionally, the fiscal court or county official must send the report to the newspaper having the largest paid circulation in the county. The letter of transmittal accompanying the report should be published in the newspaper in accordance with the provisions of KRS Chapter 424.

All A-133 Audits must be  
Submitted to:

Federal Audit Clearinghouse

1201 E 10<sup>th</sup> Street

Jeffersonville, IN 47132

<http://harvester.census.gov/sac>

DLG Audit Submission

Office of Federal Grants

1024 Capital Center Drive,

Suite 340

Frankfort, KY 40601-8204